IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

NO. 95-10872

IN THE MATTER OF: SOUTHMARK CORPORATION

Debtor

SOUTHMARK CORPORATION

Appellant,

versus

SCHULTE ROTH & ZABEL

Appellee.

(Filed July 2, 1996)

Appeal from the United States District Court
for the Northern District of Texas

Before POLITZ, Chief Judge, and WIENER and BARKSDALE, Circuit Judges.

WIENER, Circuit Judge:

In a settlement agreement entered into prior to filing for bankruptcy, Southmark agreed to reimburse a group of dissatisfied, minority-interest shareholders for expenses incurred in connection with their proxy contest and related lawsuits. Southmark now appeals the bankruptcy court's ruling that this transfer was not "for or on account of an antecedent debt owed by the debtor before such transfer was made" and thus not a preferential transfer under 11 U.S.C. § 547. Southmark also appeals

the bankruptcy court's denial of its leave to file a second amended complaint. Finding reversible error in the bankruptcy court's determination that attorneys' fees and costs were not antecedent debts, we reverse and remand.

I.

FACTS AND PROCEEDINGS

This bankruptcy case has its roots in a proxy contest waged by a group of dissatisfied, minority-interest shareholders of Southmark known as the Parks Group. The Parks Group comprised Defendants-Appellees R&P Ventures ("R&P") and Garson L. Rice, Sr., as well as former defendants Herbert B. Parks and Byron Investments, Inc. ("Byron").[1] Defendant-Appellee Schulte Roth & Zabel ("SR&Z") is a law firm, which was retained to represent the Parks Group.[2]

In March 1989, the Parks Group disclosed to the Securities and Exchange Commission ("SEC") an intention to propose nominees for election to Southmark's board of directors. In April, the group publicly announced its intention to wage a proxy contest for control of Southmark. Soon thereafter the Parks group disseminated several statements in opposition to the then-current board of directors, expressing dissatisfaction with a number of matters, such as corporate governance and

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[1] These two former defendants were non-suited after each filed for bankruptcy.

[2] Prior to our hearing oral argument in this appeal, Southmark settled with R&P and Rice, leaving SR&Z as the only defendant.

executive compensation. In these solicitation materials, the Parks Group also indicated that, to the extent legally permissible, it intended to seek reimbursement of the costs and expenses incurred in connection with the proxy contest.

Between February and May 1989, the Parks Group initiated three actions in state and federal courts in connection with the proxy contest, and Southmark initiated two actions in state and federal courts (collectively, the Lawsuits). Through its claims and counterclaims in the Lawsuits, the Parks Group sought (1) equitable and injunctive relief which included the right to examine Southmark's record of shareholders, and (2) judgments (a) blocking the implementation of, and declaring null and void, a Southmark anti-takeover "poison pill" provision, (b) prohibiting the Southmark directors from soliciting proxies unless specified disclosures were made, (c) directing the Southmark directors to cure deficiencies in their proxy statement, and (d) forcing Southmark and its directors to refrain from postponing a scheduled shareholders' meeting.[3] In two of its actions as plaintiff and in one of its counterclaims as defendant, the Parks Group requested that it be awarded costs and disbursements,

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[3] In one of its actions, the Parks Group also sought monetary damages in connection with a threatened cancellation of a scheduled shareholders' meeting. This monetary relief was sought only against the Southmark directors personally, however, not against Southmark. Southmark's by-laws provide that its directors are to be indemnified to the extent permissible under Georgia law.

including reasonable attorneys' fees, incurred in these Lawsuits.[4]

On May 24, 1989, a comprehensive settlement agreement ("Agreement") was reached with respect to the proxy contest and all of its sub-plots. In addition to, among other things, ending the proxy contest and the Lawsuits and giving the Parks Group a voice on the Southmark board of directors, the Agreement also required Southmark to reimburse the Parks Group for all expenses, including the attorneys' fees, incurred in connection with the proxy contest and the Lawsuits. The parties estimated these expenses to be $3.3 million.

At 1:00 p.m. on that same day – approximately four hours before the Agreement was formally executed – Southmark transferred the $3.3 million to SR&Z by wire. In this instance, SR&Z was acting essentially as an escrow agent. It was under instructions to return these funds to Southmark in the event that the Agreement did not get executed. But the Agreement was formally executed by about 5:00 p.m. that day, so the following morning SR&Z transferred all of these funds to R&P by wire. R&P in turn transferred almost all of the money to Byron, who, later

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[4] *See O'Neill v. Church's Fried Chicken, Inc.*, 910 F.2d 263, 265-66 (5th Cir. 1990) (describing the common law rule that allows shareholders to recover their attorneys' fees from the corporation if they show that they have conferred a substantial benefit to the corporation as a result of their efforts). This case, however, was a stockholder's derivative action; the instant case is not.

that same day, issued a check payable to SR&Z for $1 million.[5]

On July 14, 1989 – less than 90 days after the $3.3 million transfer, and thus within the preferential transfer window – Southmark filed for bankruptcy under Chapter 11. Southmark's plan of reorganization became effective on August 10, 1990. It specifies, inter alia, that reorganized Southmark is the representative of the Chapter 11 bankruptcy estate for purposes of pursuing causes of action, such as the instant one, under the bankruptcy code

On June 19, 1991, Southmark filed the original complaint in the action underlying this appeal. The members of the Parks Group were made defendants, and Southmark sought, among other things, recovery of the $3.3 million transfer as a preference under 11 U.S.C. § 547. A first amended complaint was filed on July 12, 1991.

Approximately one month later, on August 19, 1991, Rice and R&P filed their answers, denying that the transfers were preferences and asserting affirmative defenses under § 547(c). To pursue settlement, however, SR&Z obtained from Southmark several extensions of time within which to file its answer. As a result, eight additional months passed before SR&Z filed its answer on April 21, 1992.

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[5] As the district court found no preference, the amount that Southmark actually could recover from SR&Z alone, assuming that the $3.3 million transfer is a preference, is not at issue in this appeal.

On June 16, 1992, Southmark filed a motion for leave to file a second amended complaint for the purpose of making five amendments, three of which are now moot. The two amendments that are not moot sought (1) to identify the Southmark directors, sued for money damages by the Parks Group as creditors of Southmark, for whose benefit the preferential transfers were made; and (2) to add an alternative basis for recovery of the $3.3 million, i.e., that it was a *fraudulent* transfer under 11 U.S.C. § 548. Following oral argument on this motion, the bankruptcy court denied Southmark leave to amend its complaint.

Later, in April 1993, the bankruptcy court ruled on both Southmark's and the Parks Group's motions for summary judgment with respect to the preferential transfer issue. In its order, the bankruptcy court granted in part Southmark's motion for summary judgment with respect to many of the required elements under § 547. Ultimately, however, the bankruptcy court ruled in favor of the Parks Group, concluding that the $3.3 million transfer of the settlement funds was not "made for or on account of an antecedent debt owed by the debtor before such transfer was made" as required under § 547(b)(2), and thus was not a preferential transfer.

The district court affirmed both the bankruptcy court's denial of Southmark's motion for leave to amend its complaint and that court's ruling that the $3.3 million was not recoverable as a preference. Southmark now appeals both of these issues to us.

II.
ANALYSIS

A. Standard of Review

We review a bankruptcy court's denial of a motion for leave to amend a complaint under an abuse of discretion standard.[6] We review a bankruptcy court's grant of summary judgment de novo.[7] All fact questions are viewed in the light most favorable to the non-movant. Summary judgment is proper when no issue of material fact exists and the moving party is entitled to judgment as a matter of law.[8]

B. Denial of Motion for Leave to Amend Complaint

Federal Rule of Civil Procedure 15(a) provides that leave to amend pleadings "shall be freely given when justice so requires." Although Rule 15 "evinces a bias in favor of granting leave to amend,"[9] it is not automatic.[10] A decision to grant leave is within the discretion of the trial court[11] Its discretion, however, is not broad enough to permit denial if the court lacks a substantial reason to do so.[12] In deciding whether to grant such leave, the

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[6] *Wimm v. Jack Eckerd Corp.*, 3 F.3d 137, 139 (5th Cir. 1993).

[7] *In re Omni Video, Inc.*, 60 F.3d 230, 231 (5th Cir. 1995).

[8] *Id.*; Fed. R. Civ. P. 56(c).

[9] *Dussouy v. Gulf Coast Inv. Corp.*, 660 F.2d 594, 598 (5th Cir. 1981).

[10] *Wimm v. Jack Eckerd Corp.*, 3 F.3d 137, 139 (5th Cir. 1993).

[11] *Louisiana v. Litton Mortgage Co.*, 50 F.2d 1298, 1302-03 (5th Cir. 1995).

[12] *Id.*

court may consider such factors as undue delay, bad faith or dilatory motive on the part of the movant, repeated failure to cure deficiencies by amendments previously allowed, undue prejudice to the opposing party, and futility of amendment[13]

The reasons stated by the bankruptcy court for denying Southmark's leave to amend its complaint were unreasonable delay and prejudice. Specifically, the bankruptcy court concluded that the transactions on which the proposed amendments were based were known to Southmark both at the time its plan was confirmed and at the time its original and first amended complaints were filed. The bankruptcy court also noted that before filing its original complaint, Southmark had the benefit of an Examiner's Report which analyzed causes of actions that Southmark may possibly have, including this one. Further, the bankruptcy court concluded that the fact that Southmark's bankruptcy is large and complicated does not justify delay.

Finally, the bankruptcy court determined that prejudice would result to R&P and Rice[14] from the addition of a fraudulent transfer claim under 11 U.S.C. § 548, as these two defendants had stipulated to Southmark's insolvency with respect to the § 547 preference claim. Although the debtor's insolvency at the time of transfer is an element of both § 547 and § 548, § 547 (g) contains a presumption

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[13] *Foman v. Davis*, 371 U.S. 178, 182, 83 S. Ct. 227, 230, 9 L.Ed.2d 222 (1962); *Wimm v. Jack Eckerd Corp.* 3 F.3d 137, 139 (5th Cir. 1993).

[14] Recall that prior to our hearing oral argument in this appeal, Southmark settled with R&P and Rice.

of insolvency whereas § 548 does not. The bankruptcy court did not find that prejudice would result with respect to any of the other amendments sought to be made by Southmark.

The district court concluded that the reasons articulated by the bankruptcy court were sufficient and affirmed the denial of leave to amend.

In arguing that the bankruptcy court abused its discretion in denying leave to amend its complaint for a second time, Southmark contends that delay alone – as distinguished from "undue" delay – cannot justify this denial.[15] Southmark further argues that its knowledge of the transactions underlying the amendments prior to the time that the adversary proceeding was commenced is an insufficient basis for denying leave to amend.[16] The delay in this case was not "undue," insists Southmar, because at the time the Motion to Amend was filed, (1) no trial date had been set, (2) the only party that had commenced discovery was Southmark, (3) SR&Z had filed its answer only about two months earlier, in April, 1992, following a nine month "hiatus" during which the parties discussed settlement, and (4) no dispositive motions had been filed by any party. Southmark thus argues that the instant case

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[15] *See Dussouy v. Gulf Coast Inv. Corp.*, 660 F.2d 594, 599 (5th Cir. 1981).

[16] *See Carson v. Polley*, 689 F.2d 562, 584 (5th Cir. 1982) ("A litigant's failure to assert a claim as soon as he could have is properly a factor to be considered in deciding whether to grant leave to amend. Merely because a claim was not presented as promptly as possible, however, does not vest the district court with authority to punish to litigant.").

is distinguishable from a number of other cases in which the denial of leave to amend a complaint has been affirmed, noting that those other cases involved attempts to amend closer to the eve of trial or after dispositive motions had been filed.[17]

We are unpersuaded by Southmark's arguments. That many cases in which a denial of leave to amend a complaint has been affirmed involved proposed amendments closer to the eve of trial does not preclude a district court from properly exercising its discretion to deny leave to amend under particular facts like those present in the instant case. "Liberality in pleading does not bestow on a litigant the privilege of neglecting her case for a long period of time."[18] Accordingly, we have indicated that, in exercising its discretion to deny leave to amend a complaint, a trial court may properly consider (1) an "unexplained delay" following an original complaint,[19] and (2) whether the facts underlying the amended complaint were known to the party when the original complaint was filed.[20]

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[17] *E.g., Daves v. Payless Cashways, Inc.*, 661 F.2d 1022, 1025 (5th Cir. 1981) (affirming the district court's denial of leave to amend a complaint when that amendment was filed "on the eve of trial after discovery").

[18] *Id.* (discussing a motion for leave to amend a complaint under Rule 15(a)).

[19] *Id.*

[20] *Layfield v Bill Heard Chevrolet Co.*, 607 F.2d 1097, 1098 (5th Cir. 1979), *cert. denied*, 446 U.S. 939, 100 S.Ct. 2161, 64 L.Ed.2d 793 (1980).

In the instant case, Southmark sought leave to add both a fact of which it had been aware since before it filed its original complaint and a cause of action based on the identical, known facts that underlie its original complaint. This motion for leave to amend was filed approximately (1) thirty-eight months after the transfer at issue was made; (2) twenty-four months after the Examiner's Report was filed, describing the details and legal implications of this transfer; (3) thirteen months after the original complaint was filed; and (4) eleven months after the first amended complaint was found. Moreover, Southmark offers no reasonable explanation for its delay in amending its complaint.

After reviewing the record in this case, we cannot fault the bankruptcy court's discretionary determination that allowing Southmark to amend its complaint would not further the purposes of Rule 15, but to the contrary would serve only to reward Southmark for its unreasonable delay. Accordingly, we conclude that the district court did not abuse its discretion in denying Southmark's motion for leave to amend its complaint.

C. Preferential Transfer

Southmark bears the burden of proving that the $3.3 million transfer in question is avoidable as a preference.[21] The element contested in this appeal is whether under § 547(b)(2) the transfer was "for or on account of an antecedent debt owed by the debtor before such transfer

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[21] 11 U.S.C. § 547(g).

was made.[22] A debt is antecedent if it is incurred *before* the transfer.[23] Thus, this issue turns on whether, for purposes of the bankruptcy code, the Parks Group's demand for costs and attorneys' fees incurred in connection with its challenges to the corporate governance of Southmark constituted a "debt" prior to the execution of the Agreement. If it did, the debt would be antecedent; but if it only became a debt contemporaneously with the execution of the Agreement, it would not be antecedent.

The bankruptcy code defines the term "debt" as "liabilty on a claim."[24] The term "claim" is broadly defined in § 101(5) as a:

> (A) Right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured or unsecured; or
>
> (B) Right to an equitable remedy for breach of performance if such breach gives rise to a right to payment whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured.

The bankruptcy court here held that, unlike the claim for equitable relief itself, the Parks Group's affiliated request for costs and attorneys' fees was a "claim"

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[22] 11 U.S.C. § 547(b)(2).

[23] *Southmark Corp. v. Marley*, 62 F.3d 104, 106 (5th Cir. 1995), *cert denied*, ___ U.S. ___, 116 S. Ct. 815, 133 L.Ed.2d 760 (1996).

[24] 11 U.S.C. § 101(12).

because it did give rise to a right to payment in connection with the equitable relief requested. The bankruptcy court went on to hold, however, that these litigation demands were not a "debt" – even though the court acknowledged that in bankruptcy the terms "claim" and "debt" are usually synonymous.

The court reasoned that "[h]ad Southmark taken the corporate action sought by the Parks Group in the proxy contest and related Lawsuits, Southmark would have had no liability to the Parks Group for the payment of any costs and attorneys' fees. Therefore, in this case, no right to payment came into play and no debt was owed by Southmark to the Parks Group until the proxy contest and related Lawsuits were settled in accordance with the terms of the Settlement Agreement." Therefore, concluded the court, as the transfer in question was made prior to, or at least concurrently with, the Agreement's execution, the transfer was not made on account of an antecedent debt. The district court affirmed this holding on essentially the same reasoning, adding that the Parks Group could not have filed a suit for these costs and fees alone, but rather they were ancillary to the request for injunctive relief.

Southmark insists that the courts below erred in determining that there was no "debt" prior to the execution of the Agreement. We agree.

We note that at the outset that we are in agreement with the bankruptcy court's conclusion that, prior to the execution of the Agreement, the Parks Group's demand for costs and attorneys' fees did constitute a "claim" for purposes of the bankruptcy code. Although the right to

payment of these expenditures may have been disputed and even contingent, such a right is nevertheless encompassed by the expansive statutory definition of the term "claim." This conclusion also comports with the legislative history of the statute. The House and Senate Reports state that "[b]y this broadest possible definition [of the term 'claim'] . . . the bill contemplates that all legal obligations of the debtor, *no matter how remote or contingent*, will be able to be dealt with in the bankruptcy case. It permits the broadest possible relief in the bankruptcy court."[25] Thus, like the bankruptcy court, we conclude that, prior to the execution of the Agreement, the Parks Group's amicable and judicial demands for costs and attorneys' fees were "claims" within the intendment of the bankruptcy code.[26] On the other hand, we cannot agree with the bankruptcy court's conclusion that this "claim" was not a "debt." Instead, we conclude that the claim is also a debt.

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[25] H.R. Rep. No. 595, 95th Cong., 1st Sess. 309 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6266 (emphasis added); S. Rep. No.989, 95th Cong., 2d Sess. 22 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5808 (emphasis added)); *see also Johnson v,. Home State Bank*, 501 U.S. 78, 83, 111 S. Ct. 2150, 2153-54, 115 L.Ed.2d 66 (1991) ("Congress intended by [the language of 11 U.S.C. § 101 (5)] to adopt the broadest available definition of 'claim.' ").

[26] *See also In re Hadden*, 57 B.R. 187, 189 (Bankr. W.D. Wis. 1986) ("The fact that the court has some discretion in granting or denying reasonable attorneys' fees does not make [the creditor's] right to attorneys' fees so illusory as to fail to fulfill the definition of a claim.").

The legislative history of the bankruptcy code explains the relationship between debt and claim: "The terms 'debt' and 'claim' are coextensive: a creditor has a 'claim' against the debtor; the debtor owes a 'debt' to the creditor."[27] Moreover, the Supreme Court has held that the meanings of the terms "debt" and "claim" are coextensive.[28] Indeed, we have proclaimed that, based on Supreme Court authority, "there is no distinction between 'debt' and 'claim' for purposes of the Bankruptcy Code."[29]

In the absence of a compelling reason why this line of authority would not be applicable to the instant case, we conclude that, as the Parks Group had a "claim" for these expenditures prior to the execution of the Agreement, a "debt" of Southmark also existed for these expenditures prior to the execution of the Agreement.[30] Thus, the $3.3 million transfer was on account of an antecedent debt owed by Southmark.

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[27] H.R. Rep. No. 595, 95th Cong., 1st Sess. 310 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6267; S. Rep. No. 989, 95th Cong., 2d Sess. 23 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5809.

[28] *Pennsylvania Dep't of Public Welfare v. Davenport*, 495 U.S. 552, 558, 110 S. Ct. 2126, 2130, 109 L.Ed.2d 588 (1990).

[29] *In re Lindsey, Stephenson & Lindsey*, 995 F.2d 626, 628 (5th Cir. 1993), *cert. denied*, ___ U.S. ___, 114 S.Ct. 1053, 127 L.Ed.2d 374 (1994).

[30] *See In re Energy Coop., Inc.* 832 F.2d 997, 1002 (7th Cir. 1987) (in the context of analyzing whether a transfer was a preference under 11 U.S.C. § 547, stating that "[w]here a claim exists, so does a debt.").

SR&Z nevertheless argues that for Southmark to prevail on the § 547(b)(2) element in this case, there must be more than the mere existence of a "claim" prior to the exection of the Agreement. SR&Z notes that Congress could have used the word "claim" in § 547(b)(2), but chose instead to use "debt." SR&Z emphasizes that "debt" is defined in § 101 (12) as "*liability* on a claim" and thus denotes a more restrictive concept than "claim," i.e., debt is a subset of claim: all debts are claims but not all claims are debts. This argument, however, is simply unavailing in light of the contrary authorities discussed above.

SR&Z further emphasis that § 547(b)(2) requires that, to be preferential, a transfer must be "for or on account of an antecedent debt *owed* by the debtor before such transfer was made."

SR&Z insists that a debt is not "owed" until the debtor becomes "bound to pay" it; that this "owed" requirement further limits the definition of an antecedent debt. Not only does SR&Z fail to cite any authority for this suspect interpretation of the statute, but such an interpretation is contrary to established law.[31] Accordingly, SR&Z gains no support from this specious argument.

We find inescapable, therefore, that the $3.3 million was transferred "for or on account of an antecedent debt owed by the debtor before such transfer."[32] Although the

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[31] *See id* at 1001 (holding that a creditor's *contingent* claim is a debt for purposes of 11 U.S.C. § 547).

[32] 11 U.S.C. § 547(b)(2).

instant case presents a rare if not unique fact situation, it nevertheless falls within the broad statutory language of the preference statute. This conclusion is not only consistent with the statute and the case law, but also comports with the general observation that a settlement agreement resolves preexisting claims. Accordingly, we reverse the judgment of the bankruptcy court and remand for further proceedings consistent with our opinion.

III.

CONCLUSION

Even though we affirm the bankruptcy court's denial of Southmark's motion for leave to file a second amended complaint, we reverse the bankruptcy court's ruling that the $3.3 million transfer was not "for or on account of an antecedent debt owed by the debtor before such transfer."[33] Accordingly, the judgment of the bankruptcy court is

AFFIRMED in part, REVERSED in part, and REMANDED.

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[33] *Id.*

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

SOUTHMARK CORPORATION, Appellant, vs. SCHULTE, ROTH & ZABEL, et al, Appellees.	§	Bk. Adv. No. 391-3364 Case No. 3:93-CV-0906-X
SOUTHMARK CORPORATION, Appellant, vs. SCHULTE, ROTH & ZABEL, et al, Appellees.	§	Bk. Adv. No. 391-3364 Case No. 3:94-CV-0075-X (Filed Sept. 6, 1995)

MEMORANDUM OPINION AND ORDER

Before the Court is the briefing filed in each of these consolidated appeals from the bankruptcy court. Appellant Southmark Corporation ("Southmark") appeals the bankruptcy court's order entered April 5, 1993 which granted summary judgment for the defendants in the underlying adversary proceeding and granted in part and denied in part Southmark's cross-motion for summary judgment. In addition, Southmark appeals the bankruptcy court's agreed final order entered December 14, 1993 because Southmark had previously been denied leave to amend its complaint. Having carefully considered the arguments of counsel contained in their briefs,

the appellate record, and the applicable law, for the reasons discussed below, the Court determines that the bankruptcy court's orders and judgment should be, and hereby are AFFIRMED.

BACKGROUND

Herbert B. Parks ("Parks"), Appellee Garson L. Rice, Sr. ("Rice"), Appellee R&P Ventures ("R&P"), and Byron Investments, Inc. ("Byron") [hereinafter collectively the "Parks Group"], were shareholders of Southmark prior to Southmark's filing for bankruptcy. On or about March 1, 1989, the Parks Group and certain of their associates disclosed to the Securities and Exchange Commission ("SEC") their intention to propose the Parks Group's nominees for election as members of Southmark's board of directors.

On April 20, 1989 the Parks Group publicly announced their intention to wage a proxy contest for control of Southmark, and about two weeks later disseminated to Southmark's shareholders certain statements in opposition to the Southmark board. The Parks Group indicated in the solicitation materials that they were dissatisfied withthe activities of Southmark's board of directors with respect to issues of corporate governance and management, executive/director compensation, and transactions between the company and its directors and executives. The solicitation materials also disclosed the Parks Group's intention, to the extent legally permissible, to seek reimbursement of their costs and expenses incurred in connection with the proxy contest.

Between February and May 1989 the Parks Group commenced three actions against Southmark in Georgia state court and federal court in Texas, and Southmark commenced two actions against the Parks Group in these courts [hereinafter collectively "the Lawsuits"]. In their claims and counterclaims in the Lawsuits, the Parks Group sought injunctive and similar nonmonetary relief against Southmark, including the right to examine Southmark's shareholder records, a judgment enjoining the use of Southmark's "poison pill," a judgment enjoining Southmark's directors from soliciting proxies unless certain additional disclosures were made, a judgment directing Southmark to cure deficiencies in its proxy statement, and a judgment enjoining Southmark and its directors from postponing a scheduled shareholders' meeting.

In two of the three Parks Group Lawsuits and in the counterclaims asserted in one of the Southmark Lawsuits, the Parks Group sought recovery of their costs and disbursements, including reasonable attorney's fees, from Southmark. In one of the Parks Group Lawsuits, filed in Georgia state court, the Parks Group sought, in addition to injunctive relief, monetary damages from the members of the Southmark board of directors personally in connection with the board's threatened postponement of a scheduled shareholders' meeting. Southmark's by-laws provided that Southmark's directors would be indemnified to the extent permitted under Georgia law. Appellee Schulte Roth & Zabel ("SR&Z") is a New York law firm retained by the Parks Group to represent them in connection with the proxy contest and the Lawsuits.

On May 24, 1989, shortly before a scheduled shareholders' meeting, Southmark and the Parks Group

reached an overall settlement of the proxy contest and the Lawsuits and executed a written settlement agreement ("the Settlement Agreement"). SR&Z was not a party to the Lawsuits, the proxy contests, or the Settlement Agreement. The Settlement Agreement provided for: 1) the termination of the proxy contest; 2) a voice on the Southmark board for minority shareholders, including the Parks Group; 3) the appointment of three nominees of the Parks Group to the Southmark board; 4) inclusion for two years of the Parks Group's three nominees to the Southmark board in the then-current board's recommended slate of nominees; 5) agreement by the Parks Group not to engage in a proxy solicitation in opposition to Southmark or in other takeover activities; and 6) settlement and dismissal with prejudice of the Lawsuits.

The Settlement Agreement also provided for the reimbursement by Southmark of all the expenses, including the attorney's fees, incurred by the Parks Group in connection with the proxy contest and the Lawsuits (initially estimated to be $3,300,000). Section 8 of the Settlement Agreement states in relevant part:

> [Southmark] shall concurrently with the execution of this Agreement deliver to Schulte Roth & Zabel a certified check payable (or make a wire transfer of immediately available funds) to R&P Ventures in the amount of $3,300,000, which the Parks Group represents is a good faith estimate by the Parks Group of (i) its out-of-pocket expenses actually incurred through the date hereof in connection with the Parks Group's activities with respect to Southmark (other than the actual costs of investments and the carrying costs thereof), including without limitation,

> legal fees and expenses, investment banking fees, printing and mailing expenses, proxy solicitation expenses, travel expenses, public relations expenses and telephone expenses, and (ii) with respect to the actions contemplated by Section 12 [of the Settlement Agreement, concerning settlement of the Lawsuits] . . . .

Authorized representatives of Southmark and the Parks Group reached oral agreement as to the essential terms of the Settlement Agreement during the morning of May 24, 1989. At approximately 1:00 p.m. that day, before the Settlement Agreement had been formally executed by all the parties, Southmark transferred the $3,300,000 in settlement funds via a wire transfer from Southmark's bank account in Montana to the Parks Group's counsel SR&Z's bank account at Citibank in New York for SR&Z to hold in escrow until the Settlement Agreement was executed. The settlement funds were to be returned to Southmark by SR&Z if the Settlement Agreement was not executed, and were to be paid to the Parks Group by SR&Z if the Settlement Agreement was executed. The Settlement Agreement was executed in counterparts by all parties at about 5:00 p.m. on May 24, 1989, after the close of the banking day. During the morning of May 25, 1989, the settlement funds were transferred by Citibank at SR&Z's request to R&P's bank account via wire transfer.

Southmark filed its voluntary petition for relief under Chapter 11 of the Bankruptcy Code on July 14, 1989. The Fourth Amended and Restated Plan of Reorganization of Southmark Corporation became effective on August 10, 1990. The present adversary proceeding was

initiated by the filing of Southmark's original complaint on June 19, 1991 against the members of the Parks Group and SR&Z to recover certain transfers made to or for the benefit of the defendants as voidable preferences or unauthorized postpetition transfers under sections 547 and 549 of the Bankruptcy Code. Southmark filed its First Amended Complaint on July 12, 1991. Parks and Byron filed bankruptcy in North Carolina and were subsequently non-suited by Southmark, so that SR&Z, Rice and R&P remained as defendants.

Rice and R&P filed their answer on August 19, 1991, denying that the transfers were preferences or unauthorized postpetition transfers, and asserting affirmative defenses, including the defense of a contemporaneous exchange for new value, that except the payments from being voidable preferences. After extensive but ultimately unsuccessful settlement negotiations, on April 21, 1992, SR&Z filed its answer and counterclaim. On June 16, 1992, Southmark filed a motion for leave to file a second amended complaint. Following oral argument on August 25, 1992, the bankruptcy court denied Southmark leave to amend its complaint from the bench and also by subsequent order entered November 10, 1992. Southmark then filed a motion for reconsideration which was denied by order entered December 1, 1992. Southmark moved for leave to appeal the bankruptcy court's interlocutory order, and Judge Robinson denied leave to appeal on an interlocutory basis without prejudice.

Following a hearing on the transfer matter, by order entered April 5, 1993, the bankruptcy court granted Southmark's cross-motion for summary judgment in part, concluding that the transfers were property of Southmark

and were made within 90 days of the filing of Southmark's bankruptcy petition, that Rice and R&P were creditors of Southmark with respect to the $3,300,000 transfer, and that the transfers enabled the Parks Group to receive more than they would have received if Southmark had been liquidated under Chapter 7 of Bankruptcy Code and the transfers had not been made. The bankruptcy court also granted the defendants' summary judgment motion, concluding that the $3,300,000 transfer of the settlement funds was not made for or on account of an antecedent debt owed by Southmark before the transfer was made. Southmark could not meet this essential element of a preference from § 547(b)(2) of the Bankruptcy Code.

DISCUSSION

The Court has jurisdiction over these appeals pursuant to 28 U.S.C. § 158(a). The bankruptcy court's findings of fact are not to be set aside unless clearly erroneous, while its conclusions of law are subject to *de novo* review. *Matter of Jordan*, 927 F.2d 221, 224 (5th Cir. 1991). The issue presented by Southmark on appeal with respect to the transfer is the same as that before the bankruptcy court: whether the $3,300,000 prepetition transfer by Southmark on May 24, 1989 was made "for or on account of an antecedent debt owed by the debtor before such transfer was made" within the meaning of 11 U.S.C. § 547(b)(2). The issue presented by Southmark on appeal with respect to the denial of leave to file a second amended complaint is: whether the bankruptcy court abused its discretion under Rule 15(a) by denying Southmark leave to amend its complaint before substantial discovery had begun in the adversary proceeding.

The Transfer of Settlement Funds

In § 547(b) of the Bankruptcy Code, Congress broadly authorized bankruptcy trustees to avoid any transfer of an interest of the debtor in property *if* five conditions are satisfied and *unless* one of seven exceptions defined in § 547(c) is applicable. *Union Bank v. Wolas*, 502 U.S. 151, 154 (1991). The dual purposes of the preference section are to discourage creditors from racing to the courthouse to dismember the debtor during his slide into bankruptcy, and to facilitate the prime bankruptcy policy of equality of distribution among creditors of the debtor. *Id.* at 161, *citing* H.R.Rep. No. 95-595, p. 177-78, U.S. Code Cong. & Admin. News 1978 at 6137-38. The burden of proof as to the avoidability of a transfer under § 547(b) rests with Southmark. 11 U.S.C. § 547(g); *Matter of Cohen*, 875 F.2d 508, 509 (5th Cir. 1989).

The Court concludes, as the bankruptcy court did, that the $3,300,000 transfer of settlement fund was not an avoidable transfer under § 547(b) of the Bankruptcy Code because it was not "for or on account of an antecedent debt owed by [Southmark] before the transfer was made." 11 U.S.C. § 547(b)(2). The Bankruptcy Code defines debt as "liability on a claim." 11 U.S.C. § 101(12). A claim is very broadly defined as a

> right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment,

> fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured.

11 U.S.C. § 101(5). A right to payment is simply an enforceable obligation. *Pennsylvania Dept. of Public Welfare v. Davenport*, 495 U.S. 552, 559 (1990).

Southmark has failed to demonstrate the necessary elements of § 547(b)(2): that there was a debt, that this debt was antecedent to Southmark's payment to the Parks Group, and that the antecedent debt was owed by Southmark. First, there was no debt, or liability on a claim, on the Lawsuits' claims for injunctive relief, and no claim on the Parks Group's request for expenses and attorney's fees until the Lawsuits were settled by the Settlement Agreement. As explained above, the Lawsuits sought injunctive relief only against Southmark – an order giving the Parks Group the right to examine Southmark's record of shareholders a judgment declaring null and void Southmark's "poison pill," an injunction against Southmark's directors soliciting proxies unless certain disclosures were made, a judgment requiring Southmark's directors to comply with the law and cure deficiencies in their proxy statements, and an injunction against Southmark's directors postponing a scheduled shareholders' meeting.

The Parks Group sought no monetary damages against Southmark for the injunctive relief requested in the Lawsuits, so there was no debt or liability on a claim, because there was no claim, as there was no right to payment. Southmark's reliance on *Ohio v. Kovacs*, 469 U.S. 274 (1985) and its progeny is misplaced. The Court agrees with the appellees that while Southmark might have been

required to spend some money in order to comply with the equitable relief sought, the Parks Group had no right to payment, nor could the equitable relief sought been satisfied by any payment to the Parks Group.

With respect to the Parks Group's request for costs and attorney's fees, the bankruptcy court determined, and the appellees concede, that this did give rise to a right to payment in connection with the equitable relief requested so that the Parks Group had a claim against Southmark. This dovetails into the second and third prongs of § 547(b)(2) that the debt must be an antecedent debt owed by Southmark before the transfer was made, because the right to payment (enforceable obligation) did not arise until the Southmark board of directors authorized the reimbursement of the costs and attorney's fees by the execution of the Settlement Agreement. A debt is antecedent under § 547(b) if the debtor incurs it before making the alleged preferential transfer. *Matter of Southmark Corp.*, 55 F.3d 1071, 1073 (5th Cir. 1995). A debtor incurs a debt when he becomes legally obligated to pay it. *Id.* at 1074.

The Lawsuits by the Parks Group, Southmark shareholders, are not analogous to the garden variety tort and contract cases cited by Southmark in which the plaintiff asserts a right to payment arising from the defendant's breach of a duty. In contrast, the Parks Group simply sought to compel Southmark to comply with the law. The bankruptcy court noted in its order that "[had] Southmark taken the corporate action that the Parks Group sought in the proxy contest and related Lawsuits, Southmark would have had no obligation to pay the legal fees

and expenses of the Parks Group." Order at 11. Southmark had no debt, no liability on a claim or legal obligation to pay the Parks Group on the claim for reimbursement of costs and attorney's fees in the Lawsuits, until it chose to settle the Lawsuits, or until the respective courts issued final judgments in the Parks Group's favor and awarded such costs and attorney's fees. The Parks Group could not have filed a suit for these costs and fees alone; they were clearly ancillary to the request for injunctive relief.

Southmark makes much of fact that there was an oral agreement on the morning of May 24, 1989, that the Settlement Funds were later wired from its Montana bank to SR&Z's New York bank *before* the Settlement Agreement was executed that afternoon, and that the funds were transferred from SR&Z to R&P (of the Parks Group) *the following day*. Southmark contends that its debt to the Parks Group was thus antecedent to the $3,300,000 transfer. This interpretation defies common sense and contradicts the plain language of the Settlement Agreement itself. Had the oral agreement reached that morning been fully effective to close the matter, rendering the formal execution of the Settlement Agreement merely superfluous, Southmark would simply have transferred the funds directly to R&P instead of transferring them to SR&Z as escrow agent.

As quoted above, the Settlement Agreement contemplated a contemporaneous exchange, providing in Section 8 that Southmark "shall concurrently with the execution of this Agreement deliver to Schulte Roth & Zabel" its certified check or make a wire transfer of the Settlement Funds. Section 24 provides that the Settlement Agreement

"shall be a binding agreement between the parties thereto upon the due execution of counterparts by the Company, a majority of the members of the Current Board, the members of the Parks Group and the Parks Nominees." The Settlement Agreement is therefore binding upon execution in written form, not when the "parties reached a handshake agreement regarding important terms of settlement" earlier that morning, as Southmark contends. The Settlement Agreement was not executed until about 5:00 p.m. on the afternoon of May 24, 1989, after the close of the banking day so that the funds could not have been transferred until the following day. The Parks Group had the right to the Settlement Funds at the moment of execution, *after* the Settlement Funds had been transferred by Southmark, and the mere fact that its counsel could not deliver the funds until the following business day did not transform the exchange into a transfer made on account of an antecedent debt.

Denial of Leave to Amend the Complaint

Southmark filed its voluntary petition for relief under Chapter 11 of the Bankruptcy Code on July 14, 1989 and instituted this adversary proceeding by filing its original complaint on June 19, 1991. Southmark filed its First Amended Complaint on July 12, 1991, filed its motion for leave to amend its complaint a second time on June 16, 1992, and amended the motion for leave to amend on July 6, 1992. Southmark's proposed Second Amended Complaint introduced five amendments, two of which have since become moot. The three amendments at issue in this appeal would: 1) sue Rice in his capacity as general partner of R&P (he had previously been sued

in his individual capacity only); 2) identify the Sothmark directors sued for money damages by the Parks Group as creditors of Southmark for whose benefit the preferential transfer to the Parks Group were made; and 3) add a new claim for recovery of the $3,300,000 transfer as a fraudulent transfer under U.S.C. § 548.

The bankruptcy court denied leave to amend based on Southmark's unreasonable delay in seeking to amend its complaint a second time. Specifically, the bankrupcty court found that the transactions upon which the proposed amendments are based were known to Southmark when its plan was confirmed in 1990 and when it filed its Original Complaint and First Amended Complaint in 1991. The transactions at issue occurred more than three years before Southmark sought to amend its complaint. The bankruptcy court also noted that Southmark filed these actions with the benefit of the report of the bankruptcy Examiner from 1990 which analyzed potential causes of action Southmark would have under the Bankruptcy Code. Although Southmark had a large and complicated bankruptcy case, the size of the case did not justify Southmark's delay. Finally, the bankruptcy court found that prejudice would result to R&P and Rice if Southmark were permitted to add the fraudulent transfer claim.

Under Rule 15(a) of the Federal Rules of Civil Procedure, leave to amend "shall be freely given when justice so requires." In deciding whether to grant leave to file an amended pleading, the court may consider such factors as undue delay, bad faith or dilatory motive on the part of the movant, repeated failure to cure deficiencies by amendments previously allowed, undue prejudice

to the opposing party, and futility of amendment. *Wimm v. Jack Eckerd Corp.*, 3 F.3d 137, 139 (5th Cir. 1992); *Foman v. Davis*, 371 U.S. 178, 182 (1962). This Court reviews the bankruptcy court's decision denying Southmark leave to amend its complaint under an abuse of discretion standard. *Wedgeworth v. Fibreboard Corp.*, 706 F.2d 541, 546 (5th Cir. 1983).

The Court concludes that the bankruptcy court did not abuse its discretion in denying Southmark leave to amend its complaint. Undue delay alone is a sufficient basis for denying leave to amend. *See Topalian v. Ehrman*, 954 F.2d 1125, 1139 (5th Cir.), *cert. denied*, 113 S.Ct 82 (1992). The Fifth Circuit has affirmed the denial of leave to amend in other cases where, as here, the movant knew the facts relevant to the proposed amendment when its previous pleading was filed. *Barrett v. Indep. Order of Foresters*, 625 F.2d 73, 75 (5th Cir. 1980); *Layfield v. Bill Heard Chrevrolet Co.*, 607 F.2d 1097, 1099 (5th Cir. 1979), *cert. denied*, 446 U.S. 939 (1980).

Southmark's continued attempts (twice before the bankruptcy court, once before Judge Robinson, and once again before this Court) to justify its unreasonable delay in seeking leave to amend its complaint are unavailing. The Court finds particularly disingenuous Southmark's argument before the bankruptcy court at oral argument (and before the Court in its reply brief) that it had only recently learned that Rice was general partner of R&P so that its delay in suing Rice in that capacity was warranted:

> I think having had a number of discussions and after reviewing the first round of written discovery responses, we now have learned as of May

> 21 [1992] that R and P Ventures is a partnership between Rice and Parks. While that may seem, like the name suggests that R and P, we didn't know and we didn't have anything to substantiate that.

Counsel for Southmark, Hearing of Aug. 25, 1992, Transcript at 7. In one of the five Lawsuits that were settled on May 24, 1989, Rice as plaintiff had stated that he was a general partner of R&P. Southmark obviously knew in May 1989 about Rice's status as a general partner of R&P, but waited until June 1992 to decide that it wished to sue him in that capacity. The Court agrees with the appellees that, at best, Southmark was simply unsure about Rice's potential liability, and at worst, Southmark was less than diligent in determining which parties it should sue. This Court will not reward Southmark for such unreasonable delay.

The Court finds Southmark's arguments similarly unpersuasive as to the fraudulent transfer claim and allegation that the Southmark directors were creditors. Southmark asserts that it wasn't until SR&Z's answer was filed in April 1992 that it was clear that all the defendants were taking the position that there was no antecedent debt for which Southmark had paid the $3,300,000 transfer. But Southmark knew when R&P and Rice filed their answer in August 1991 that the antecedent debt element of its preference claims was at issue. Southmark could have pleaded its preference and fraudulent transfer claims in the alternative from the beginning in its original complaint filed in June 1991. The Court finds no abuse of

discretion in the bankruptcy court's denial of Southmark's Motion for leave to amend its complaint because of Southmark's undue delay.

Finally, the bankruptcy court found as an additional basis for denying leave to amend, that Southmark's proposed amendment of its complaint would prejudice R&P and Rice. The Court agrees with the bankruptcy court's reasoning, explained succinctly in its order denying Southmark's motion for reconsideration:

> The liberal rules permitting amended pleadings does not mean that the court lacks discretion to deny amendments under appropriate circumstances. Southmark offers no new arguments in this motion. Southmark has known about its cause of action under 11 U.S.C. § 548 since prior to the confirmation of its plan of reorganization in July 1990. Rather than timely plead, Southmark waited until the defendant had been trapped into a material admission of the element of Southmark's insolvency on the date of transfer before seeking to plead the § 548 cause of action.
>
> In requests for admissions submitted pursuant to Southmark's first amended complaint, the defendant conceded insolvency under 11 U.S.C. § 547. Now Southmark would amend the complaint to add the cause of action under 548 with insolvency already established. Southmark argues that the defendant can withdraw its admission. That cannot remedy the prejudice. The defendant has already admitted to the court Southmark's insolvency. Although the defendant may not otherwise be prejudiced by the amended complaint, the irreparable prejudice of a material admission of an element of a cause of

> action is dispositive. Southmark's undue delay has prejudiced the defendant concerning the admission of that material element.

As with the bankruptcy court's determination of undue delay, the Court finds that the denial of leave to amend on the basis of undue prejudice was not an abuse of discretion.

CONCLUSION

For the reasons discussed above, the bankruptcy court's orders entered April 5, 1993 and December 14, 1993 and judgment are AFFIRMED.

SO ORDERED this 6th day of September, 1995.

/s/ Joe Kendall
Joe Kendall
U.S. District Judge

Robin E. Phelan
State Bar No. 15903000
Judith Elkin
State Bar No. 06522200
Susan L.S. Ernst
State Bar No. 18519600
HAYNES AND BOONE, L.L.P.
3100 NationsBank Plaza
901 Main Street
Dallas, Texas 75202-3789
Telephone: (214) 651-5000
Telecopy: (214) 651-5940

ATTORNEYS FOR DEFENDANT
SCHULTE ROTH & ZABEL

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

IN RE:	§	
	§	Case No.
SOUTHMARK CORPORATION,	§	389-36324-SAF-11
	§	
Debtor.	§	

SOUTHMARK CORPORATION,	§	
	§	
Plaintiff,	§	Adversary No.
	§	391-3364
v.	§	(Filed Apr. 5, 1993)
SCHULTE ROTH & ZABEL, R&P VENTURES, AND GARSON L. RICE, SR.,	§	
	§	
Defendants.	§	

ORDER GRANTING DEFENDANTS' SUMMARY JUDGMENT MOTIONS AND GRANTING IN PART AND DENYING IN PART PLAINTIFF'S CROSS-MOTION ON CERTAIN ISSUES

On the 7th day of January, 1993, came on for hearing the Motions for Partial Summary Judgment filed by Defendant Schulte Roth & Zabel ("SR&Z") and the Motion for Summary Judgment filed by Defendants Garson L. Rice, Sr. ("Rice") and R&P Ventures ("R&P") (collectively, the "Summary Judgment Motions"), and the Cross-Motion for Partial Summary Judgment (the "Cross-Motion") filed by Plaintiff Southmark Corporation ("Southmark"); and the Court, after hearing oral argument by counsel for the parties and upon review of the briefs, affidavits and other summary judgment evidence on file in this case, finds and concludes as follows:

1. Rice, R&P and SR&Z filed the Summary Judgment Motions on September 15, 1992, requesting summary judgment on numerous issues set out in Southmark's First Amended Complaint for Avoidance and Recovery of Preferential and Postpetition Transfers (the "Complaint") with regards to the transfer described in the Complaint as the $3.3 Million Transfer.

2. On November 16, 1992, the parties entered into a Stipulation Regarding Motions for Summary Judgment (the "Stipulation") which was approved by the Court. According to the Stipulation, the January 7, 1993 hearing on the Defendants' Summary Judgment Motions was limited to:

a. the issue raised by SR&Z, Rice and R&P of whether the $3.3 Million Transfer was made for or on

account of an antecedent debt owed by Southmark before the transfer was made as required by section 547(b)(2) of the Bankruptcy Code, and

b. the issue raised by Rice and R&P of whether the $3.3 Million Transfer is protected by the contemporaneous exchange for new value defense contained in section 547(c) of the Bankruptcy Code. Defendants Rice and R&P subsequently withdrew this issue from consideration at the hearing.

3. On or about December 7, 1992, Southmark filed its Cross-Motion seeking the following determinations:

a. that the $3.3 Million Transfer, the $9,208 Transfer, the $10,651.64 Transfer and the $50,000 Transfer (collectively, the "Transfers") sought to be avoided in the Complaint constituted transfers of Southmark's property;

b. that the $3.3 Million Transfer, the $9,208 Transfer and the $10,651.64 Transfer (the "Alleged Preferential Transfers") were made to or for the benefit of a creditor as required by section 547(b)(1) of the Bankruptcy Code;

c. that the Alleged Preferential Transfers were for or on account of an antecedent debt owed by Southmark before the Alleged Preferential Transfers were made as required by section 547(b)(2) of the Bankruptcy Code;

d. that the Alleged Preferential Transfers were all made within ninety (90) days of the petition date as required by section 547(b)(4); and

e. that the Alleged Preferential Transfers enabled the Defendants to receive more than they would have been entitled to receive if Southmark had been liquidated under chapter 7 of the Bankruptcy Code and each

Alleged Preferential Transfer had not been made as required by section 547(b)(5) of the Bankruptcy Code.

4. Each Defendant stipulated as to the elements set out in paragraphs 3(a) and (d), above. Defendants Rice and R&P stipulated as to the element set out on paragraph 3(e), above. All other elements raised in Southmark's Cross-Motion for Partial Summary Judgment were submitted to the Court for determination.

5. No disputed issues of material fact exist with respect to the issues being submitted to the Court in Defendants' Motions for Partial Summary Judgment and Southmark's Cross-Motion for Partial Summary Judgment, and summary judgment is proper as set forth below.

6. The ruling of the Court is based on the following undisputed facts:

a. On or about March 1, 1989, R&P, Rice, Herbert B. Parks ("Parks"), and Byron Investments, Inc. ("Byron") (collectively, the "Parks Group") and certain associates of the Parks Group, disclosed to the Securities and Exchange Commission their intention to propose the Parks Group's nominees for election as members of the board of directors of Southmark. At the time, the members of the Park Group were all shareholders of Southmark. On April 20, 1989, the Parks Group publicly announced its intention to wage a proxy contest for control of Southmark, and approximately two weeks later disseminated to Southmark's shareholders certain statements in opposition to the then current board of directors. The Parks Group

indicated in its solicitation materials that it was dissatisfied with the activities of Southmark's board of directors in regards to, among others, issues of corporate governance and management, executive/director compensation and transactions between the company and its directors and executives. The solicitation materials also contained a statement that, to the extent legally permissible, the Parks Group intended to seek reimbursement of the costs and expenses incurred by it in connection with the proxy contest.

b. In connection with the proxy contest, the Parks Group commenced three actions against Southmark in Georgia state court and Texas federal court (the "Parks Group Lawsuits"), and Southmark commenced two actions against the Parks Group in Georgia state and federal courts (the "Southmark Lawsuits"), between February and May 1989 (collectively, the "Lawsuits"). SR&Z, with the assistance of local counsel, acted as counsel for the Parks Group in connection with the proxy contest and the Lawsuits.

c. In the Parks Group Lawsuits and in counterclaims asserted in one of the Southmark Lawsuits, the Parks Group sought a variety of forms of injunctive and similar nonmonetary forms of relief, including the right to examine Southmark's record of shareholders, a judgment enjoining the effectiveness of, and declaring null and void, a Southmark "Poison Pill", a judgment enjoining the Southmark directors from soliciting proxies unless certain disclosures were made, a judgment directing the Southmark directors to cure deficiencies in their proxy statement and a judgment enjoining Southmark

and its directors from postponing a scheduled shareholders' meeting. In two of the three Parks Group Lawsuits and in the counterclaims asserted in one of the Southmark Lawsuits, the Parks Group requested that it be awarded the costs and disbursements, including reasonable attorneys' fees.

d. In one of the Parks Group Lawsuits, filed on May 22, 1989 in Georgia state court, the Parks Group sought, in addition to injunctive relief, monetary damages in connection with the threatened postponement by the Southmark board of a scheduled shareholders' meeting. The Parks Group only sought this relief from the directors of Southmark personally, and not from Southmark itself. Southmark's By-Laws provided that Southmark's directors would be indemnified to the extent permitted under Georgia law.

e. An overall settlement of the proxy contest and the Lawsuits was reached and documented by the 24th of May, 1989. The substance of the settlement is more fully described in the Settlement Agreement dated May 24, 1989 (the "Settlement Agreement"), entered into between Southmark, the Parks Group, and certain other individuals. SR&Z was not a party to the Lawsuits, the proxy contest or the Settlement Agreement. The Settlement Agreement provided for, *inter alia*, the termination of the proxy contest, a voice on the Southmark board for minority shareholders (including the Parks Group), the appointment of three nominees of the Parks Group to the Southmark board, the inclusion for two years of the current nominees in the board's slate of nominees recommended for election, the agreement by the Parks Group not to engage in a proxy solicitation in opposition to

Southmark or other takeover activities and the settlement and dismissal with prejudice of the Lawsuits.

f. The Settlement Agreement did provide for the reimbursement of all the expenses, including the attorneys' fees, incurred by the Parks Group in connection with the proxy contest and the Lawsuits. Section 8 of the Settlement Agreement is entitled "Reimbursement of Expenses" and provides as follows:

> [Southmark] shall concurrently with the execution of this Agreement deliver to Schulte Roth & Zabel a certified check payable (or make a wire transfer of immediately available funds) to R&P Ventures in the amount of $3,300,000, which the Parks Group represents is a good faith estimate by the Parks Group of (i) its out-of-pocket expenses actually incurred through the date hereof in connection with the Parks Group's activities with respect to Southmark (other than the actual costs of investments and the carrying costs thereof), including, without limitation, legal fees and expenses, investment banking fees, printing and mailing expenses, proxy solicitation expenses, travel expenses, public relations expenses and telephone expenses, and (ii) with respect to the actions contemplated by Section 12 [of this Settlement Agreement]. [Section 12 concerned settlement of the Lawsuits.]. . . .

g. Authorized representatives of Southmark and the Parks Group reached oral agreement as to the essential terms of the Settlement Agreement late in the morning of May 24, 1989. At approximately 1 o'clock p.m. on May 24, 1989, before the Settlement Agreement had been formally executed by all parties thereto, Southmark transferred the Settlement Funds via a wire transfer from Southmark's

bank account at First Bank Havre in Havre, Montana, to SR&Z's bank account at Citibank, N.A. in New York. The Settlement Funds were to be returned to Southmark by SR&Z if the Settlement Agreement was not executed, and were to be paid to the Parks Group by SR&Z if the Settlement Agreement was executed. The Settlement Funds were held in SR&Z's bank account for less than 24 hours.

h. The Settlement Agreement was executed in counterparts by about 5 o'clock p.m. on May 24, 1989. During the morning of May 25, 1989, the entire amount of the Settlement Funds was transferred by Citibank, at the request of SR&Z in accordance with the instructions of its client, to R&P's bank account, via wire transfer.

i. The Settlement Agreement provided for Southmark to nominate certain members of the Parks Group (the "Parks Nominees") as members of Southmark's Board of Directors. Section 2(c) of the Settlement Agreement provided, in part, that:

> The Parks Nominees will be entitled to separate independent counsel, the reasonable fees and disbursements of which will be paid by the [Southmark].

j. On or about June 22, 1989, Southmark delivered check number 0152266 in the amount of $9,208.00 (previously referred to herein as the "$9,208 Transfer") to SR&Z for services rendered to the Parks Nominees through May 31, 1989. On or about July 13, 1989, Southmark wire transferred the sum of $10,651.64 (previously referred to herein as the "$10,651.64 Transfer") to SR&Z for services rendered to the Parks Nominees through June 30, 1989.

Additionally, on or about July 13, 1989, Southmark wire transferred the sum of $50,000.00 (previously referred to herein as the "$50,000.00 Transfer") to SR&Z as an "advance payment retainer" for future services to be rendered to the Parks Nominees. Neither the $9,208.00 Transfer, the $10,651.64 Transfer nor the $50,000 Transfer are included in Defendants' Motions for Partial Summary Judgment, but certain elements of the causes of action related thereto are the subject of Southmark's Cross-Motion for Partial Summary Judgment.

k. Southmark filed its petition for Chapter 11 bankruptcy protection on July 14, 1989.

l. The Alleged Preferential Transfers enabled to Defendants to receive more than they would have been entitled to receive if Southmark had been liquidated under chapter 7 of the Bankruptcy Code and each Alleged Preferential Transfer had not been made as required by section 547(b)(5) of the Bankruptcy Code.

7. No genuine issue of fact exists for trial that all the Transfers constituted property of Southmark, that the Alleged Preferential Transfers were made within ninety (90) days of the filing of Southmark's bankruptcy petition, that Rice and R&P were creditors of Southmark with respect to the $3.3 Million Transfer, that the Alleged Preferential Transfers enabled the Parks Group to receive more than they would have received if Southmark had been liquidated under chapter 7 of the Bankruptcy Code and the Alleged Preferential Transfers had not been made with respect to the applicable Defendant, all as required by section 547(b) of the Bankruptcy Code. Therefore,

Plaintiff's Cross-Motion for Partial Summary Judgment should be granted as to these issues.

8. No genuine issue of material fact exists for trial that the $3.3 Million Transfer was not made for or on account of an antecedent debt owned by Southmark before the $3.3 Million Transfer was made. This element of a preference, which is contained in section 547(b)(2) of the Bankruptcy Code, is essential to Southmark's case and cannot be met by Southmark. Therefore, Defendants' Motions for Partial Summary Judgment should be granted, Southmark's Cross-Motion for Partial Summary Judgment on this issue should be denied, and the cause of action set out in the Compliant for the recovery of the $3.3 Million Transfer should be dismissed.

9. The underlying dispute that arose prepetition in the proxy contest and the related Lawsuits is one dealing with corporate governance as it applies to Southmark. The corporate governance issue is an equity matter which does not give rise to a right to payment, and therefore, does not constitute a claim under section 101(5)(B) of the Bankruptcy Code. However, the affiliated request for costs and attorneys' fees by the Parks Group did give rise to a right to payment in connection with the equitable relief requested. Therefore, the Parks Group had a claim against Southmark.

10. In order for a payment to be preferential, section 547(b)(2) of the Bankruptcy Code requires that a payment be for or on account of an antecedent debt owed by the debtor before the payment is made. While claim and debt are ordinarily synonymous, this is not always the case. Had Southmark taken the corporate action that the Parks

Group sought in the proxy contest and related Lawsuits, Southmark would have had no obligation to pay the legal fees and expenses of the Parks Group, and therefore, Southmark would have had no liability to the Parks Group for the payment of any costs and attorneys' fees. Therefore, in this case, no right to payment came into play and no debt was owed by Southmark to the Parks Group until the proxy contest and related Lawsuits were settled in accordance with the terms of the Settlement Agreement.

11. While the definition of the word "liability" is broad, the Court must read section 547(b)(2) of the Bankruptcy Code in its entirety. In that section, Congress has emphasized that the debtor had to have had an obligation to make the payment before the payment sought to be avoided is made. Here, Southmark had no obligation to make the monetary payment until the proxy contest and related Lawsuits were settled in accordance with the terms of the Settlement Agreement. Therefore, the $3.3 Million Transfer was not made for or on account of an antecedent debt owed by Southmark before the $3.3 Million Transfer was made, and Southmark cannot meet its burden of proof under section 547(b)(2) of the Bankruptcy Code on this issue.

12. The Court would not reach a different result based on policy reasons. First, while it appears that the Defendants get to keep the $3.3 Million Transfer, which was made a few weeks prior to the filing of Southmark's bankruptcy petition, while more traditional trade creditors and bondholders would not be able to keep such a payment, this result is not as inequitable as it appears. To the extent a trade creditor or bondholder is required to

return a preferential payment to a debtor, the trade creditor or bondholder gets a claim in the bankruptcy case and shares in the dividends distributed to all such creditors. Defendants, however, are not creditors of Southmark in the traditional sense. R&P and Rice were shareholders of Southmark, and any claim they had based on corporate governance issues could have been resolved without any liability for expenses and legal fees. As interest holders, their interests would have been eliminated in the bankruptcy case unless they made a contribution to the reorganization or otherwise persuaded the creditor body to let them keep some interest. SR&Z was not a creditor of Southmark with respect to the $3.3 Million Transfer.

13. Second, section 547 of the Bankruptcy Code is, by its nature, unfair to individual creditors, although it is fair to the estate and creditors generally. Therefore, it must be strictly construed by the Court to apply to only those situations where Congress determined it should apply. Where one draws the line in how broadly to apply the section is a matter for Congress and not this Court.

14. Third, Southmark appears to be after the wrong defendants. Southmark has asked the Court to look at the ultimate economics of the Settlement Agreement and the $3.3 Million Transfer. The directors of Southmark were the other defendants in the Lawsuits. They are the ones who benefitted from the $3.3 Million Transfer because they were released from multi-million dollars worth of claims by the Settlement Agreement. Success on such claims would have gone to Southmark since they were technically part of a derivative action for harm to the corporation. The directors could not have been entitled to any kind of indemnity in such a situation. Southmark has

released these directors from any claims Southmark might have had against them as part of the comprehensive settlement contained in its confirmed plan of reorganization. The Court does not have a problem with this, but the Court must consider the fact that these directors were the beneficiaries of the Transfer Southmark is seeking to avoid in weighing the economics and the effect of policy on its ruling.

BASED ON THE FOREGOING, IT IS THEREFORE ORDERED as follows:

1. Plaintiff's Cross-Motion for Partial Summary Judgment is hereby granted in part on the following elements:

a. that the Transfers sought to be avoided in the Complaint constitute transfers of Southmark's property;

b. that the Alleged Preferential Transfers were made to or for the benefit of a creditor as required by section 547(b)(1) of the Bankruptcy Code;

c. that the Alleged Preferential Transfers were all made within ninety (90) days of the petition date as required by section 547(b)(4); and

d. that the Alleged Preferential Transfers enabled the Defendants to receive more than they would have been entitled to receive if Southmark had been liquidated under chapter 7 of the Bankruptcy Code and each Alleged Preferential Transfer had not been made as required by section 547(b)(5) of the Bankruptcy Code.

2. On the element contained in section 547(b)(2) of the Bankruptcy Code, whether the $3.3 Million Transfer

was made for or on account of an antecedent debt owed by Southmark before the $3.3 Million Transfer was made, Defendants' Motions for Partial Summary Judgment are hereby granted and Southmark's Cross-Motion for Partial Summary Judgment on this issue is hereby denied. Therefore, the cause of action set out in the Complaint for the recovery of the $3.3 Million Transfer is hereby dismissed.

3. The Court does not reach the issue raised by Rice and R&P of whether the $3.3 Million Transfer is protected by the contemporaneous exchange for new value defense contained in section 547(c) of the Bankruptcy Code because it was withdrawn from consideration, and the Court's ruling on section 547(b)(2), as set forth above, is dispositive and makes such determination unnecessary.

4. There is no just reason for delay. Therefore, it is hereby ordered that this judgment be entered at once pursuant to Rule 54(b) of the Federal Rules of Civil Procedure and Rule 7054 of the Federal Bankruptcy Rules.

SIGNED this 2 Day of April, 1993.

ORIGINAL SIGNED BY
/s/ STEVEN A. FELSENTHAL
STEVEN A. FELSENTHAL
UNITED STATES
BANKRUPTCY JUDGE

AGREED AS TO FORM ONLY:

SCHULTE ROTH & ZABEL

/s/ Judith Elkin
Judith Elkin
HAYNES AND BOONE, L.L.P.
3100 NationsBank Plaza
901 Main Street
Dallas, Texas 75202
(214) 651-5000

ATTORNEYS FOR DEFENDANT,
SCHULTE ROTH & ZABEL

SOUTHMARK CORPORATION
Agrees to form of order, but does not have authority from client to sign.
Larry Chek
JENKINS & GILCHRIST, P.C.
3200 Fountain Place
1445 Ross Avenue
Dallas, Texas 75202
(214) 855-4500

ATTORNEYS FOR PLAINTIFF,
SOUTHMARK CORPORATION

GARSON L. RICE, SR.
R & P VENTURES

/s/ William B. Sullivan
William B. Sullivan
WOMBLE, CARLYLE, SANDRIDGE & RICE
One Triad Park, Suite 1600
200 West Second Street
Winston Salem, North Carolina 27101
(919) 721-3600

ATTORNEYS FOR DEFENDANTS,
GARSON L. RICE, SR. AND R & P VENTURES

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 95-10872

In The Matter Of: SOUTHMARK CORPORATION
Debtor

SOUTHMARK CORPORATION
Appellant

v.

SCHULTE ROTH & ZABEL
Appellee

Appeal from the United States District Court
for the Northern District of Texas, Dallas

ON PETITION FOR REHEARING AND SUGGESTION FOR REHEARING EN BANC

(Filed Aug. 1, 1996)

(Opinion 7/2/96, 5 Cir., 1996, ___ F.3d ___)

(August 1, 1996)

Before Politz, Chief Judge, and WIENER and BARKSDALE, Circuit Judges.

PER CURIAM:

The Petition for Rehearing is DENIED and no member of this panel nor judge in regular active service on the court having requested that the court be polled on

Rehearing En Banc, (FRAP and Local Rule 35) the Suggestion for Rehearing En Banc is also DENIED.

ENTERED FOR THE COURT:

/s/ Jacques L. Wiener, Jr.
United States Circuit Judge

CLERK'S NOTE:
SEE FRAP AND LOCAL RULES 41 FOR STAY OF THE MANDATE.